This record is a partial extract of the original cable. The full text of the original cable is not available.

UNCLAS SECTION 01 OF 02 BRASILIA 003349

SIPDIS

SENSITIVE

NSC FOR CRONIN
TREASURY FOR OASIA - DAS LEE AND FPARODI
STATE PASS TO FED BOARD OF GOVERNORS FOR ROBITAILLE
USDOC FOR 4332/ITA/MAC/WH/OLAC/JANDERSEN/ADRISCOLL/MWAR D
USDOC FOR 3134/ITA/USCS/OIO/WH/RD/DDEVITO/DANDERSON/EOL SON

E.O. 12958: N/A
TAGS: ECON EFIN ETRD PGOV EIND BR
SUBJECT: BRAZIL WILL BEGIN NEW YEAR WITHOUT A FEDERAL BUDGET; FINANCE MINISTER TO RUN FOR FEDERAL DEPUTY?

REF: A) BRASILIA 3207
B) BRASILIA 3092
C) BRASILIA 3286 (NOTAL)

¶1. (SBU) Summary: Brazil will begin 2006 without having approved a federal government budget. Federal Deputy (congressman) Colbert Martins told Emboff December 20 he believes the budget would not be passed until February. The GoB will be limited to paying salaries and current expenses (utilities, rent, etc.) until Congress approves a budget. The lack of investment and other discretionary spending during the first month or two of the presidential election year, however, while unrelated to Finance Minister Palocci's desire to keep overall fiscal policy tight, will likely expose him to renewed criticism of the Finance Ministry's over-performance of its primary surplus target (refs A and B). Indeed, rumors have been circulating recently that Palocci will resign to run for federal deputy by the March 31 deadline for federal officials to leave the government before an election. While the constant attacks, particularly those from within the GoB, must be wearing on Palocci, in our view he is more vulnerable to the emergence of new evidence of wrong-doing in the ongoing political scandal (refs B and C) than to the friendly fire. Even if Palocci departed and were replaced with an advocate of a more malleable fiscal policy, pro-spending forces within the GoB would be hard-pressed, given bureaucratic limitations, to conduct a significantly looser fiscal policy during the three to four month window between the passage of the budget and June 1, when election law limits on public sector investment spending kick in. End Summary.

No Budget Until February

¶2. (SBU) In a December 20 meeting, Federal Deputy Colbert Martins (Social Popular Party -- PPS, Bahia), a member of the joint budget committee, told Emboff that the budget approval process, for which the Congress has been called into special session, had only just begun. The committee, he stated, would begin working on the seven sectoral budgets this week. In the new year, these would be joined into one overall budget document, which could be voted out of committee for consideration by the full Chamber of Deputies and full Senate beginning January 16. Based on his experience, he did not expect an approved budget to be in place before February 2006. After December 31 and until the budget is passed, Martins said, the GoB was authorized by the already-approved budget directives law (LDO) to make outlays for salaries and current expenditures only. No money could be obligated for other outlays, including investment. (Note: the GoB also has authority to continue servicing its debt even in the absence of a budget.)

¶3. (SBU) Reflecting on the recent political pressure on the Finance Ministry to increase investment expenditures, Martins suggested there would be sharp debate on this issue within Congress in the coming weeks. While this would generate political noise, he said, the fact was that since the GoB budget is an authorization only, of which the execution by the Executive Branch is not mandatory, Congress has much less leverage than it would like over actual expenditures. (In practice, Brazilian presidents have traditionally used their power to release/sequester expenditures to entice wayward parliamentarians to vote in accordance with the Executive's wishes.) Martins expected that Palocci would continue to be subjected to substantial criticism on fiscal policy over the next months, both from frustrated Deputies and Senators as well as the pro-spending forces within the Cabinet. Martins further argued that reducing discretion in GoB budget execution would promote transparency as it would make it more difficult for public money to be "redirected" for corrupt purposes.

Palocci Departure Rumors Redux

¶4. (SBU) Against this budgetary backdrop, the press reported

on December 19 that Palocci may leave his post to run for Federal Deputy or to work on Lula's campaign. The move would be part of a broader cabinet shakeup expected in early 2006 as those ministers who want to run for federal elected office must, by law, resign by March 31, 2006. According to these reports, Palocci told friends he is unwilling to remain as Finance Minister and "bleed in public" should the attacks against him continue. Should Palocci resign, Central Bank Chief Meirelles could leave as well -- depending upon whom Lula chose to replace Palocci.

¶5. (SBU) Comment: This most recent round of rumors about a Palocci departure appears to be simply the latest variant of what has become the routine scenario in the last few months: Palocci resists pressure, mostly from within the GoB and within his own party, to release funds for election-year investment projects while, on a second front, fighting off allegations of wrongdoing during his tenure as mayor of Ribeirao Preto. Although Palocci must surely be tired of the constant friendly fire, we believe it more likely his departure would be caused by the emergence of new evidence substantiating the allegations of corruption/wrongdoing. The lack of an approved budget adds a new wrinkle to the story, for even if Palocci did leave and were replaced with a figure that pursued a more malleable fiscal policy, the window for significant election-related spending will be narrow. Combined with the inability of Brazil's creaky bureaucracy to spend all of the funds released to it by the Finance Ministry, the pro-spending forces within the GoB would likely find moving money out the door more challenging than expected.

CHICOLA